

GUIDELINES FOR FY15 LFC APPROPRIATION RECOMMENDATION

I. PURPOSE

The LFC budget guidelines provide analysts with direction on performance-based budgeting, the preparation of the budget narrative, and the development of FY15 recommendations on recurring appropriations, priority capital spending, and other one-time investments. The guidelines also serve to inform state agencies and the general public about the LFC priorities and the committee's approach to budget recommendations for FY15.

II. REVENUE OUTLOOK

The Consensus Revenue Estimating Group revised preliminary FY13 revenues downward by \$9.6 million from February 2013, contributing to a decrease in FY13-ending reserves to \$570 million (10.1 percent). The revenue estimating group also reduced the forecast for FY14 revenues downward by \$135.7 million. Given FY14 recurring appropriations of \$5.89 billion, reserves at the end of FY14 are projected to be \$449.1 million (7.6 percent).

The August consensus revenue estimate decreased the FY15 forecast by \$4.4 million to \$6.19 billion. "New Money" – defined as FY15 projected revenue less FY14 recurring appropriations – is estimated at \$295 million, an increase of 5.0 percent over the FY14 recurring appropriation level.

III. FY15 PRIORITY AND APPROACH

The goal of the committee is to propose a balanced budget for the operations of government that improves service levels, increases accountability, and ensures at least a 10 percent general fund reserve. The committee will recommend a balanced budget focused on improved education, early childhood investment, public health, workforce development and public safety outcomes, the protection of vulnerable citizens, and increased economic growth.

Overall, the committee will emphasize limited general fund appropriation growth in most state agency budgets. Growth in general fund appropriations will be considered on a case-by-case basis to address changes in program caseload, workload, or waiting lists, medical and per diem inflationary costs, and needs related to the implementation of funding formula changes. The committee will remain cognizant of potential declines in federal revenue as a result of sequestration.

The committee will recommend funds to increase the employer contribution to the Education Retirement Board (ERB) by 0.75 percent and the Public Employee Retirement Association (PERA) by 0.4 percent to improve the solvency of public employee pension funds consistent with statute.

Further, LFC analysts shall:

- Carefully consider committee direction when evaluating agency base budgets and requests for additional funding or staff;
- Identify opportunities for consolidating or streamlining duplicate programs and activities, eliminating earmarks, and enhancing efficiency;
- Identify successful programs that provide the best return to taxpayers and programs not producing positive results or are of lower priority to the state, and;
- Use cost-saving opportunities and evidence-based analysis to prioritize agency funding and improve performance outcomes.

IV. PERFORMANCE AND ACCOUNTABILITY

The Accountability in Government Act (AGA) remains a top priority. Analysts shall integrate agency performance results into their budget analysis and, whenever possible, align budget recommendations with program achievement. Consideration for continued base funding should be given to those programs that demonstrate results, effective design, and strong planning and management. Analysts should follow these guidelines in reviewing agency performance:

- Agency strategic plans should ensure: 1) the stated mission, goals and objectives are consistent with statute and state policies; 2) overarching programs are coordinated among divisions and, where applicable, across agencies, and; 3) programs are consistent with current resources and conditions. Agency resources should be aligned with the agency's strategic direction and performance results.
- Performance targets should be benchmarked for priority programs whenever possible. Suggested resources for benchmarking include federal standards, best practice standards set by other agencies and states, historical data and desired results. Analysts should recommend new or alternative performance measures that better gauge program outcomes as necessary.
- Performance data and results from recent LFC program evaluations should be used to identify programs that are ineffective or producing marginal results or, conversely, are achieving desired outcomes.

Analysts' FY15 budget recommendation will ensure all programs, sub-programs, and initiatives are reviewed to identify those that:

- Are no longer needed because goals or other conditions have been met or changed;
- Exhibit mission drift or have demonstrated limited success in fulfilling their missions;
- Are restricted in scope, thus limiting impact or efficiency;
- Are unfocused, cannot demonstrate effectiveness or cannot be evaluated;
- Are not effective according to external evaluations;
- Cannot clearly exhibit benefits;
- Are high cost, or;
- Could be funded by user fees or other alternative sources.

In select cases, analysts may recommend additional performance measures in the FY15 budget to hold agencies accountable for achieving program results.

V. BUDGET GUIDELINES

The following budget guidelines apply to all agencies.

Full-Time Equivalents (FTE) Positions and Vacancy Rates. In recent years the number of people employed in state government has declined; however, funding has not been reduced commensurate with this lower level of employment. As a result, agency budgets continue to reflect high vacancy rates, and agencies continue to transfer or revert large amounts of appropriated personal services and employee benefits (PS&EB) funding. Using the personal services and employee benefits vacancy analysis worksheet, analysts shall reconcile full-time equivalent (FTE) positions by classification (permanent, term, temporary), with the FTE authorized in Laws 2013, Chapter 227 and, in calculating recommendations for PS&EB appropriations to the committee, shall consider:

- Eliminating nonessential vacant FTE positions;
- Reducing revenue sources that support nonessential vacant FTE positions;
- Budget adjustments that occurred in previous fiscal years moving funds from the personal services and employee benefits category to other appropriation categories;
- Historical agency vacancy rates, funded and unfunded vacancy rates, and the actual agency vacancy rate at the time of budget submission;
- Funding levels that ensure agencies meet AGA performance measures;
- Sources of funding and mechanisms by which funding is transferred to the State Personnel Office (SPO) to complete “shared services” human resource activities normally pursued by the agency, and;
- Potential fiscal liabilities for state agencies related to the AFCSME/CWA Supreme Court decision.

Vacant positions not eliminated by the analyst should be budgeted at a salary level that ensures effective recruitment and retention of qualified candidates for state government.

The committee recommendation for state and judicial branch agencies will no longer reference the number of authorized FTE for agencies with fewer than 200 FTE.

Expenditures and Contractual Services. Analysts shall evaluate the rationale behind increases or decreases in agency expenditures in the budget request compared to prior years. Where an agency has made significant non-recurring expenditures, analysts shall consider adjusting expenditure levels downward for FY15 as necessary. Analysts are directed to carefully analyze requested expenditures for professional services contracts. This analysis should address: 1) whether the proposed contracts address agency priorities; 2) performance criteria, and; 3) agency monitoring activities. Analysts shall use the monthly *Contracts Report* provided by the DFA and information in the New Mexico Sunshine Portal to analyze an agency’s historical use of contractual services. Analysts should note shifts of workload from FTE to contractors and ensure the cost of performing the work is not double funded.

Building Lease Costs. To engage agencies in reducing the size of the state lease footprint, analysts shall evaluate alternatives to leasing, such as relocation to vacant state buildings or use of capital funds for new facilities. Analysts shall consider reduced funding for locations with a high number of square feet per FTE, high costs per FTE; and leases for space that do not currently, or may not in the near future, meet the agency's needs. Analysts shall consider state space standards, reduced staffing levels, current lease terms and conditions, and market factors such as commercial property lease rates for a particular geographical area. Analysts shall encourage agencies with favorable lease terms that expire in the next three years to renegotiate lower rates immediately in exchange for extended terms.

Revenues and Cash Balances. Analysts shall determine if estimates of non-state revenue sources in the agency requests (other revenues and other transfers) are reasonable based on grants, awards, agreements, and program history. To reduce the need for revenue from the general fund, analysts shall examine cash balance levels and, where possible, use cash balances in the FY15 budget recommendation. It is preferable that cash balances be recommended for nonrecurring purposes. Governing statutes shall be reviewed to determine if funds are budgeted appropriately and if they can be used for other purposes. Analysts shall scrutinize expenditures where an earmarked revenue is in decline or unavailable.

Federal Funds. Federal funds should be leveraged to the maximum extent possible in keeping with the committee's policy priorities to ensure these funds are accurately reflected in the budget recommendation. Analysts are directed to compare the information on the R-forms provided in the budget requests with historical budget adjustment activity, deviations from the General Appropriation Act in the operating budget, the LFC federal funds schedule for key agencies, the database provided by the Federal Funds Information for States (FFIS) service, and other sources of information on federal funds. Analysts shall also use historical budget adjustment request (BAR) information to determine if the level of federal funds is accurately reflected in the agency request. Analysts shall ensure agency budget requests do not substitute declining federal funds with general fund and other state funds resulting from sequestration.

Base Expansion. Analysts shall critically review the merits of any expansions of existing base programs. (Workload growth is not considered a program change.) Analysts shall avoid financing expansions with nonrecurring revenue. Generally, expansions, other than those identified as a committee priority, must be financed through reprioritization of current appropriation levels. All expansions must be tied to enhanced performance and explained in the budget document accordingly. Expansion positions should be budgeted for a partial year if it is unlikely they will be filled by July 1, 2014.

Capital Outlay. Analysts shall consider operating budget implications when reviewing requests for new facility construction, renovation, expansion, or demolition. Analysts shall review agency Infrastructure Capital Improvement Plans (ICIP), agency compliance with Executive Order 2012-023 (Facility Master Planning Guidelines), Executive Order 2013-006 (Uniform Funding Criteria, Grant Management, and Oversight), the LFC quarterly reports, and monitor the progress and project outcome of significant capital appropriations made in previous years. Recommendations shall consider funding in operating budgets for maintenance and renewal in future years.

Information Technology Request. Analysts shall consider operating budget implications, such as ongoing maintenance, training, and impacts on operations, when reviewing requests for new or extended information technology (IT) projects. Staff shall review IT appropriations from previous years and monitor the progress and outcome of ongoing IT projects. Recommendations for new IT projects shall be based on conformance with stated agency priorities, agency and statewide IT plans, the quality of the specific business case, and available funding. Notwithstanding the aforementioned criteria, to reflect ongoing concern over the lack of IT oversight in New Mexico, analysts shall not recommend funding for non-essential IT projects (those not necessary to protect health, welfare or public safety) until the state's Information Technology Commission has been reconvened and is equipped to meet its oversight objectives as described in statute.

Agency Audit Reports. Analysts shall use the agency's financial audit reports in preparing the FY15 budget recommendation and pay close attention to reversions and unreserved/undesignated fund balances. It is important to have timely completion of the audit. Significant audit findings shall be reported to the LFC.

Budget Adjustment Requests. Budget adjustment data provides historical information regarding an agency's real budget needs. Analysts shall incorporate historical budget adjustment review (BAR) information to identify opportunities to evaluate the adequacy of program funding and the potential to shift funding to other areas. Analysts are directed to review BAR language in the General Appropriation Act and to propose modified language that clarifies any ambiguities or closes loopholes.

VI. TAX EXPENDITURES

The committee shall review tax expenditures to identify uses of state funds that do not meet the intended purpose or are not cost-effective and can be re-directed to higher priority uses.

VII. OTHER FINANCIAL ISSUES

In addition to agency operating budgets and revenues, committee staff should review the impact other financial issues may have on state finances and make appropriate considerations and recommendations to the committee including:

Federal Funding/Sequestration. With passage of the Federal Budget Control Act of 2011 and the recent actions of Congress, states are facing possible declines ranging from 3 percent to 10 percent for federal fiscal years (FFY) 14 and 15. There are some exemptions, primarily for low-income and transportation programs. The education, energy, environment, justice, community development, housing, labor, and low-income home energy assistance programs and the social services block grant will likely see these more substantial reductions in FFY14 through FFY15. Additionally, defense spending could see a 10 percent reduction for FFY14. New Mexico could experience impacts due to federal and military employment reductions as well as procurement and defense contracting decreases. The Budget Control Act established a different sequestration process for FFY13 than for ensuing years. For FFY13, discretionary reductions (both defense and nondefense) were achieved by automatic across the board spending cuts. For FFY14 through FFY21, the discretionary reductions are achieved through a downward adjustment to the spending caps (enforced by sequestration). For nonexempt, mandatory spending, automatic across the board spending cuts will take place each year.

Judicial and Magistrate Pension Fund Solvency. The state continues to face significant growth in funding requirements for its magistrate and judicial pension benefit plans. For the fiscal year ending June 30, 2012, the magistrate and judicial retirement funds were each about 50 percent funded and had a total unfunded liability just under \$100 million. The main causes of this deteriorating funding status include contributions rates that are far from adequate to satisfy the annual required contribution and the benefits. In addition, funding for these retirement plans relies substantially on fluctuating docket fees which remain an unstable source of annual revenue. The Legislature should consider amending the Judicial and Magistrate Retirement Acts to bring the plans into greater parity with the other PERA plans for state employees, including reducing the pension multiplier, changing age and service requirements, increasing employee and employer contributions, and decreasing the annual cost-of-living adjustment.

Medicaid Expansion Due to the Patient Protection and Affordable Care Act. Pursuant to the federal Patient Protection and Affordable Care Act, New Mexico is expanding Medicaid eligibility for adults with incomes up to 138 percent of the federal poverty level starting on January 1, 2014. The federal government will cover 100 percent of the cost of these new enrollees for the first three years, but the federal match declines to 90 percent in 2020. Enrollment of newly-eligible adults is expected to exceed 100,000 and will impact a number of current programs serving this population. Many clients currently receiving state funded behavioral health services will likely receive these services under Medicaid, which could allow the committee to reallocate general fund appropriations to address other shortfalls in social service programs. Careful analysis of the costs and benefits of the Patient Protection and Affordable Care Act will be necessary to determine the cost of state general fund revenues due to increased Medicaid enrollment, as well as the impact of increased Medicaid spending (in particular federal funds) on state revenues, employment, and health care access. It may be desirable to consider a trigger for deauthorization of the Medicaid expansion if long-term federal funding commitments are not maintained.

Accountability Issues in Medicaid Supported Programs. The state's \$4 billion Medicaid program continues to struggle with accountability issues in a number of areas, including behavioral health, the developmental disabilities waiver, sole-community provider hospital payments and long-term services. Allegations of provider billing fraud, service quality issues, and agency program management issues are a concern. A number of agencies play key roles in ensuring accountability of Medicaid programs including the Human Services Department (HSD), the Department of Health, and the Office of the Attorney General. The Legislature supported increased state funds for additional Medicaid oversight staff at the HSD and completed a number of performance evaluations of Medicaid funded programs as well as a report on Medicaid fraud, waste, and abuse controls. Improvement of agency oversight and aggressive action against Medicaid fraud are expected and agency performance should be taken into consideration as part of funding decisions.

Public School Funding Formula. Priorities include formula changes to ensure funding is directed toward closing the achievement gap and ensuring the state meets federal special education maintenance-of-effort (MOE) requirements. Three recent independent evaluations indicate the need to increase funding for the state's most at-risk students. The current formula places little weight, as compared with other components and other states' formulas, on the

additional incremental costs associated with educating these students. The at-risk index is complex and does not fully cover the additional costs of educating at-risk students. Changes to the at-risk index could likely be implemented with new recurring funding. Revenue allocated through the funding formula has been insufficient in recent years to meet federal MOE requirements, and resulted in unique appropriations in FY13 and FY14. Unique solutions may again be necessary in FY15, including the use of non-recurring funding to replace reduced federal special education allocations if the state's waiver appeal for FY11 is denied.

Road Fund Adequacy. Projections for the state road fund indicate revenues will be relatively flat and will not return to previous levels as quickly as expected. Chronic and extensive funding gaps related to the maintenance and preservation of highways, roads, and bridges across the state are expected to continue into the foreseeable future. Analysts shall consider funding options and recommendations of the Interim Transportation Infrastructure Revenue Subcommittee to address the sustainability of the state transportation infrastructure, including major investment projects critical to economic welfare and public safety.

Lottery Fund Solvency. With relatively flat revenues from lottery sales and increasing use of fund balances to support scholarships, the state made additional funding available in FY14 to meet the Legislative Lottery Scholarship Program's rising tuition costs. Even still, the state will be unable to provide full tuition scholarships to eligible students in FY14. Pursuant to Senate Memorial 101, a working group comprised of legislators and leaders from the Higher Education Department and institutions are examining alternatives to existing funding sources and program criteria. The group's efforts may lead to program solvency measures that support the state's student completion goals.

Economic Growth and Workforce Development. New Mexico's job growth is improving but falls well below the national average and lags every state in the region except Wyoming. The state's total labor force remains slightly below pre-recession levels, and median income ranks second lowest in the country. The state's workforce training and development programs are coming under increasing pressure to prepare and retrain its citizens for current and prospective job opportunities, especially in light of underemployment and regional unemployment levels in New Mexico. However, these programs often overlap, duplicate administrative costs, are fragmented, and do not report on outcomes. Analysts shall review existing and proposed programs related to economic development and workforce training to address these concerns and identify evidence-based investments to improve labor force quality, assist job growth, and promote increasing personal income levels.

Oversight and Accountability in State Agencies. Although many state agencies already have an office inspector general (OIG), quality assurance (QA) or other audit function, they may currently lack sufficient independence and flexibility required to effectively investigate potential misuse of public funds. To ensure greater transparency and accountability in state government and improve coordinated executive management of internal controls, the committee may consider more effective fiscal oversight, transparency and accountability over the expenditure of appropriated funds for agencies with OIG, QA and internal audit functions.